

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Cardoza Analyst: Colin Stevens Bill Number: AB 1513

Related Bills: See Legislative History Telephone: 845-3036 Amended Date: 5/12/98

Attorney: Doug Bramhall

Sponsor:

**SUBJECT:** Agricultural Prunings Delivered to Biomass Conversion Facility Credit

### SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to \$30 for each ton of agricultural prunings grown in California and delivered without charge to a biomass facility in a form suitable for biomass conversion. The credit would be certified by the Department of Food and Agriculture (DFA) and allowed only to the grower of the agricultural prunings.

### SUMMARY OF AMENDMENT

The May 12, 1998, amendments removed the prior provision of the bill that made legislative findings and declarations regarding the Legislature's intent to implement methods of financial assistance to ensure the retention of the biomass industry during and after deregulation of the electricity market and inserted the provisions discussed in this analysis.

### EFFECTIVE DATE

This bill would apply to taxable or income years beginning on or after January 1, 1998, and before January 1, 2008.

### LEGISLATIVE HISTORY

SB 2086 (1996), SB 38 (Stats. 1996, Ch. 954), SB 1216 (1997)

### SPECIFIC FINDINGS

**Federal law and state laws** contain a variety of provisions specifically relating to farmers and agriculture. These provisions include special accounting and inventory methods, certain income deferral conditions, capital gain-ordinary loss treatment, the deduction of items normally capitalized, and exempt status for labor, agricultural, or horticultural organizations.

**Existing federal and state laws** provide various tax credits that are designed to provide tax relief for taxpayers who incur certain expenses (e.g., child and dependent care credits) or to influence behavior, including business practices and decisions (e.g., research credits, enterprise zone or program area hiring credits). These credits provide incentives for businesses to perform actions which they may not otherwise do, may not do at the desired location, etc.

#### Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department/Legislative Director

Date

Gerald H. Goldberg

6/1/98

**Existing state law** provides general rules which apply to the division of credits when multiple taxpayers, including partnerships, share in the costs used as the basis of the credit. These rules apply unless an individual credit specifies different rules.

**Existing state law** limits the low-income housing credit and the research credit to the tax attributable to the taxpayer's passive activities. (Two expired credits, the jobs credit and the orphan drug credit, also were subject to this limitation.) The purpose of the passive activity loss (PAL) limitation is to prevent taxpayers from using a credit from a passive activity to offset tax attributable to other non-passive income. Credit amounts in excess of the PAL limitation may be carried over to offset tax attributable to passive income in subsequent years.

Except as specified, **state law** does not allow any tax credit to reduce regular tax below the tentative minimum tax for purposes of the alternative minimum tax (AMT) calculation.

**This bill** would create a tax credit equal to \$30 for each ton of agricultural prunings, as defined by DFA regulation, grown in California and delivered without charge to a facility for biomass conversion, in a form suitable for biomass conversion at the facility. The credit would be allowed only to the grower of the prunings.

For purposes of this bill, "grower" would mean the owner or operator of an agricultural facility which produces prunings in the normal course of producing agricultural products. Owner-operators of biomass facilities would be specifically excluded from the definition of a "grower."

For purposes of this bill, biomass conversion is defined by reference to Section 40106 of the Public Resources Code, which provides that biomass conversion is the controlled combustion, when separated from other solid waste and used for producing electricity or heat, of the following:

- agricultural crop residues;
- bark, lawn and yard and garden clippings;
- leaves, silvicultural residue, and tree and brush pruning; and
- wood, wood chips, and wood waste.

This bill would require that the DFA:

- obtain the taxpayer's identification number, including those of individual partners and S corporation shareholders;
- certify the delivery of the prunings in a form usable for biomass conversion to the facility;
- issue the certificate to the taxpayer and provide the taxpayer with a copy of the certification to retain for his or her records; and
- provide an annual listing to the FTB of taxpayers issued certificates and of the tonnage of prunings delivered by each taxpayer.

**This bill** would provide that if a taxpayer's allowable credit could not be used in any given year, the excess credit could be carried over for up to ten years or until exhausted, whichever occurs first.

The general rules regarding the division of credits would apply, and this credit would not reduce regular tax below the tentative minimum tax for AMT purposes. This credit is not included in the list of passive activity credits; therefore, taxpayers who generate this credit from passive activities would be able to use the credit to offset tax attributable to non-passive income.

#### Policy Considerations

Credits typically are provided to offset the cost of an expense. This credit would not be determined by reference to the taxpayer's actual costs.

This bill would require a taxpayer to reduce any deduction for the expense of delivering prunings by the amount of credit allowed, but would not require a taxpayer to reduce a deduction for the expense of preparing prunings for delivery to a biomass facility (e.g. shredding, chopping, etc.).

#### Implementation Considerations

Department staff is available to assist the author's office with this and other considerations that may be identified.

This bill would require the DFA to provide a certification to the taxpayer, but does not require the taxpayer to provide it to the FTB upon request. Without the certification, the department could have difficulty implementing the bill. Amendments 3 and 10 would resolve this concern by requiring the taxpayer to provide a copy of the certification to the FTB upon request.

According to discussions with the author's office, a deduction for the cost of transporting prunings would be reduced by the amount of the credit. Amendments 6 and 13 would clarify that only transportation costs would be reduced by the amount of credits allowed. The disallowance of deductions in the case of a third party hauler would be easily administered by department auditors. However, the disallowance of deductions attributable to prunings hauled by a grower would be more difficult for department auditors to determine.

#### Technical Considerations

The considerations shown below, identified in the department's analysis of the bill as amended May 1, 1997, still apply and are reiterated below. The attached amendments would resolve the technical considerations shown below.

This bill would define "pruning" as the process of removing limbs, buds, flowers, but would not define "prunings," the item for which a credit would be allowed. Amendments 5 and 12 would define "prunings," using similar terminology.

The credit should be allowed against the net tax or tax, rather than against "the amount of" net tax or tax. Amendments 1 and 7 would delete the unnecessary language.

The definition for a grower provides that a grower may be an "owner or operator" of an agricultural facility. That same provision specifies that an "owner-operator" of a biomass facility shall not be considered a grower. Amendments 4 and 11 would make consistent the use of the term "owners or operators" by striking "owner-operators" and inserting "owners or operators".

For purposes of the Revenue and Taxation Code, a partnership or an S corporation is a taxpayer. Therefore, the reference to partnerships and S corporations in the certification language would imply that they are not taxpayers. Amendments 2 and 9 would make a grammatical change to ensure that they are identified as taxpayers.

This bill provides that any unused credit may be carried over after the repeal date. Amendments 8 and 14 would delete this carryover language since existing law already provides that the carryover of a credit may continue past its repeal date.

#### REGULATIONS

According to staff from the Department of Food and Agriculture, that department would need to adopt regulations defining agricultural prunings to implement this bill.

#### FISCAL IMPACT

##### Departmental Costs

This bill would not significantly impact the department's costs.

##### Tax Revenue Estimate

Based on the data and assumptions discussed below, revenue losses from this measure are estimated as follows:

Revenue Impact of <b>AB 1513</b> - As Amended May 12, 1998 Taxable/Income Years After 12/31/1997 and Before 01/01/2008 (In \$Millions)			
Fiscal Years	1998-99	1999-00	2000-01
Revenue Impact (Rounded)	(1)	(1)	(1)

This estimate does not account for any changes in employment, personal income, or gross state product that might result from this bill.

##### Tax Revenue Discussion

The revenue impact of this bill would depend on the amount of qualified agricultural prunings delivered in a suitable form to biomass facilities as certified by the Department of Food and Agriculture and the tax liabilities of affected taxpayers.

The estimated impact of this bill was determined in the following steps:

- ◆ The California Biomass Energy Alliance survey in 1996 indicated that about 7 million tons of wastes were burnt in California biomass plants that year.
- ◆ According to data from the California Environmental Protection Agency report from February 1997 ("Cost Shifting Strategies for the Biomass Power Industry"), the biomass power industry burns fuel that originated from three sources: forest wastes (mill waste and in-forest residue), urban wood wastes (construction and demolition debris, pallets, and wood from park and street maintenance), and agricultural wastes (rice hulls and straw, orchard prunings, manure, and other).
- ◆ The same report presented the distribution of fuel type consumed by California biomass facilities during the year 1993: 60% of fuel was originated from the forest residue, 21% from the urban wastes, and 19% from agriculture wastes. The 19% rate was applied to the total fuel consumption in 1996, which yields 1,330,000 bone dry tons (BDT) of agricultural wastes burnt in that year.
- ◆ According to information from the California Biomass Energy Alliance, it was estimated that orchard prunings do not exceed 15% of agricultural fuel. This yields fewer than 200,000 BDT of orchard prunings per year.
- ◆ Currently California growers generally eliminate prunings by burning them in the field, or by contracting with about 200 companies for the collection of the prunings, their chipping, and delivery to the biomass facilities at a charge. Few growers deal directly with the biomass facility. Given current practice and the fact that under this bill the biomass facility could not be charged, it was assumed that perhaps 10% of growers would meet this bill's requirements and apply for the credit. This projection considered that over 40% of California farms reported no positive taxable income (according to departmental data).
- ◆ With a deduction offset applied, revenue losses would be on the order of \$1 million annually beginning in the fiscal year 1998/99.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 1513  
As Amended May 12, 1998

AMENDMENT 1

On page 2, line 6, strike "amount of"

AMENDMENT 2

On page 3, line 3, strike "or" and insert "and,"

AMENDMENT 3

On page 3, between lines 5 and 6, insert:

(d) To be eligible for the credit allowed under this section, the taxpayer shall do all of the following:

(1) Provide the Department of Food and Agriculture with documents and other information, as deemed necessary by the department, verifying that the prunings and delivery meet the requirements specified in this section.

(2) Retain a copy of the certificate issued by the Department of Food and Agriculture as specified in subdivision (c).

(3) Provide a copy of the certificate specified in subdivision (c) to the Franchise Tax Board upon request. If the taxpayer fails to comply with the requirements of this subdivision, no credit shall be allowed to that taxpayer under this section for any taxable year unless the taxpayer subsequently complies.

(4) Provide the Department of Food and Agriculture with his or her taxpayer identification number, and in the case of a partnership, the taxpayer identification numbers of all partners.

**@@@ Leg Counsel: Please redesignate subdivisions as necessary**

AMENDMENT 4

On page 3, line 11, strike "Owner-operators" and insert

Owners or operators

AMENDMENT 5

On page 3, amend lines 13-14 as follows:

of this section, ~~"pruning"~~ "prunings" mean ~~the removal of~~ branches, limbs, buds, or flowers removed from a tree grown in this state for

AMENDMENT 6

On page 3, line 18, strike "expense" and insert:

transportation costs

AMENDMENT 7

On page 3, strike lines 27-28.

AMENDMENT 8

On page 3, line 33, strike "amount of"

AMENDMENT 9

On page 4, line 20, strike "or" and insert "and,"

AMENDMENT 10

On page 4, between lines 22 and 23, insert:

(d) To be eligible for the credit allowed under this section, the taxpayer shall do all of the following:

(1) Provide the Department of Food and Agriculture with documents and other information, as deemed necessary by the department, verifying that the prunings and delivery meet the requirements specified in this section.

(2) Retain a copy of the certificate issued by the Department of Food and Agriculture as specified in subdivision (c).

(3) Provide a copy of the certificate specified in subdivision (c) to the Franchise Tax Board upon request. If the taxpayer fails to comply with the requirements of this subdivision, no credit shall be allowed to that taxpayer under this section for any income year unless the taxpayer subsequently complies.

(4) Provide the Department of Food and Agriculture with the taxpayer's identification number, and in the case of a subchapter S corporation, the taxpayer identification numbers of all shareholders.

**@@@ Leg Counsel: Please redesignate subdivisions as necessary.**

AMENDMENT 11

On page 4, line 28, strike "Owner-operators" and insert:

Owners or operators

AMENDMENT 12

On page 4, amend lines 30-31 as follows:

of this section, ~~"pruning"~~ "prunings" mean ~~the removal of~~ branches, limbs, buds, or flowers removed from a tree grown in this state for

AMENDMENT 13

On page 4, line 35, strike "expense" and insert:

transportation costs

AMENDMENT 14

On page 5, strike lines 5-6.